

MUSICK, PEELER & GARRETT LLP

ATTORNEYS AT LAW
One Wilshire Boulevard, Suite 2000
Los Angeles, California 90017-3383
TELEPHONE 213-629-7612
FACSIMILE (213) 624-1376

Susan J. Field (State Bar No. 086200)
s.field@mpglaw.com
Richard S. Conn (State Bar No. 065513)
r.conn@mpglaw.com
Barbora Pulmanova (State Bar No. 234028)
b.pulmanova@mpglaw.com

Attorneys for NATIONAL INDEMNITY COMPANY

**UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA**

STEVE POIZNER, INSURANCE
COMMISSIONER OF THE STATE
OF CALIFORNIA, in his capacity as
Liquidator of Frontier Pacific Insurance
Company,

Plaintiff,

vs.

NATIONAL INDEMNITY
COMPANY, a Nebraska corporation;
and DOES 1 through 10,

Defendant.

Case No. 08 CV 772 L (POR)

Assigned to the Hon. M. James Lorenz
Courtroom 14

Complaint Filed: March 17, 2008

**MEMORANDUM OF POINTS AND
AUTHORITIES IN SUPPORT OF
DEFENDANT NATIONAL
INDEMNITY COMPANY'S
MOTION TO STAY
PROSECUTION OF ACTION
PENDING ARBITRATION OF
CLAIMS**

**[NOTICE OF MOTION;
DECLARATION OF RICHARD S.
CONN; DECLARATION OF
JOSEPH CASACCIO; AND
[PROPOSED] ORDER FILED
CONCURRENTLY HEREWITH]**

**DATE: August 18, 2008
TIME: 10:30 a.m.
COURTROOM: 14**

Defendant National Indemnity Company submits the following
Memorandum of Points and Authorities in support of its Motion to Stay Proceedings
Pending Arbitration:

TABLE OF CONTENTS

	<u>Page</u>
I. STATEMENT OF MATTERS IN CONTROVERSY.....	2
II. GROUNDS FOR RELIEF SOUGHT	6
III. ARGUMENT: THE COURT SHOULD STAY THIS ACTION PENDING ARBITRATION OF CLAIMS	7
A. The Parties' Arbitration Agreements Unambiguously Require Arbitration Of This Dispute.	7
1. Both Federal And California Law Strongly Favor Arbitration And Require That Arbitration Agreements Be Broadly Construed.....	8
2. Under The Foregoing Standard, The Dispute Presented Here Is Within The Scope Of The Parties' Agreements To Arbitrate And Must Be Arbitrated By The Commissioner.....	11
B. Arbitration Of Reinsurance Disputes Is Particularly Appropriate.....	12
C. The Order Of The Liquidation Of FPIC Is No Bar To The Relief Sought.....	14
IV. CONCLUSION	16

TABLE OF AUTHORITIES

CASES

<i>Ainsworth v. Allstate Insurance Co.</i> , 634 F. Supp. 52 (W.D. Mo. 1985).....	8, 11
<i>Allen v. Ramsay</i> , 179 Cal. App. 2d 843, 4 Cal. Rptr. 575 (1960)	12
<i>Anderson v. Great Republic Life Insurance Co.</i> , 41 Cal. App. 2d 181, 106 P.2d 75 (1940).....	12
<i>Bennett v. Liberty National Fire Ins. Co.</i> , 968 F.2d 969 (9th Cir. 1992).....	11, 12
<i>Bernstein v. Centaur Insurance Co.</i> , 606 F. Supp. 98 (S.D.N.Y. 1984)	8
<i>Bos Material Handling, Inc. v. Crown Controls Corp.</i> , 137 Cal. App. 3d 99, 186 Cal.Rptr. 740 (1982).....	9
<i>Campeau Corp. v. May Dept. Stores Co.</i> , 723 F. Supp. 224 (S.D.N.Y.1989).....	7
<i>Complaint of Hornbeck Offshore</i> , 981 F.2d 752 (5th Cir. 1993).....	7
<i>Dean Witter Reynolds, Inc. v. Byrd</i> , 470 U.S. 213, 105 S.Ct. 1238 (1985)	9
<i>Gutierrez v. Academy Corp.</i> , 967 F. Supp. 945 (S.D. Tex. 1997).....	7
<i>Houston General Insurance Co. v. Realex Group, N.V.</i> , 776 F.2d 514 (5th Cir. 1985).....	13
<i>Local Union No. 370, Int'l Union of Operating Eng'rs v. Morrison-Knudson Co.</i> , 786 F.2d 1356 (9th Cir. 1986)	10
<i>Mass v. Melymont</i> , 1 Misc. 3d 906A, 2003 WL 23138786 (N.Y. Dist. Ct. 2003).....	5
<i>Merrill Lynch, Pierce, Fenner & South Inc. v. Lauer</i> , 49 F.3d 323 (7th Cir. 1995)	7
<i>Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.</i> , 473 U.S. 614, 105 S.Ct. 3346 (1985)	8, 9
<i>Moses H. Cone Memorial Hospital v. Mercury Construction Corp.</i> , 460 U.S. 1, 103 S.Ct. 927 (1983)	8, 9

1	<i>National Union Fire Ins. Co. v. Belco Petroleum Corp.</i> ,	
	88 F.3d 129 (2d Cir. 1996)	10
2	<i>Pacific Indemnity Co. v. Insurance Co. of North America</i> ,	
3	25 F.2d 930 (9th Cir. 1928)	13
4	<i>People v. Gonzalez</i> ,	
	12 Cal.4th 804, 50 Cal. Rptr. 2d 74 (1996)	16
5	<i>Petition of Home Ins. Co.</i> ,	
6	908 F. Supp. 180 (S.D.N.Y. 1995)	7
7	<i>Prima Paint Corp. v. Flood & Conklin Mfg.</i> ,	
	388 U.S. 395 (1967)	10
8	<i>Quackenbush v. Allstate Insurance Co.</i> ,	
9	121 F.3d 1372 (9th Cir. 1997)	10, 11, 12, 16
10	<i>Republic of Nicaragua v. Standard Fruit Co.</i> ,	
	937 F.2d 4698 (9th Cir. 1991)	
11	<i>cert. den.</i> 503 U.S. 919	10
12	<i>Rodriguez de Quijas v. Shearson/ American Express, Inc.</i> ,	
	109, S.Ct. 1917, 104 L.Ed.2d 526 (1989)	10
13	<i>Shearson/American Express, Inc. v. McMahon</i> ,	
14	482 U.S. 220, 107 S.Ct. 2332 (1987)	10
15	<i>Southland Corp. v. Keating</i> ,	
	465 U.S. 1, 104 S.Ct. 852 (1984)	8
16	<i>U.S. Dept. of Treasure v. Fabe</i> ,	
17	508 U.S. 491, 113 S.Ct. 2202 (1993)	12
18	<i>United States v. South Eastern Ass'n</i> ,	
	322 U.S. 533, 64 S.Ct. 1162 (1944)	8
19	<i>United Steelworkers of America v. Warrior Gulf Navigation Co.</i> ,	
20	363 U.S. 574, 80 S.Ct. 1347 (1960)	9
21		
22	<u>STATUTES</u>	
23	15 U.S.C. § 1012(b)	12
24	15 U.S.C. §§ 1011-15	12
25	9 U.S.C. § 3	6, 14
26	9 U.S.C. § 4	7
27		
28		

1 FOREIGN AUTHORITIES

2 *Kivort Steel Inc. v. Liberty Leather Corp.*,
3 110 A.D.2d 950, 487 N.Y.S.2d 877 (1985).....5

4 OTHER AUTHORTIES

5 4 B. Witkin, *California Procedure*,
6 Pleading § 127 at 160 (1985).....12
7 K. Thompson, Reinsurance (4th Ed. 1966)13

8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

1

2 **I. STATEMENT OF MATTERS IN CONTROVERSY**

3 This action has been brought by Steve Poizner, Insurance
 4 Commissioner of the State of California ("Plaintiff" or "Commissioner"), in his
 5 capacity as Liquidator of Frontier Pacific Insurance Company ("FPIC").
 6 (Complaint, p. 1) Plaintiff seeks "a determination that [FPIC's] right to recover
 7 monies owed by National Indemnity Company ("NICO") pursuant to an indemnity
 8 contract is not subject to any claim of offset for monies that were presently owed to
 9 NICO from Frontier Insurance Company ("Frontier"), FPIC's parent company."
 10 (Complaint, p. 2, ¶ 1) Frontier and FPIC are subject to state court supervised
 11 insolvency proceedings in New York and California, respectively. (Complaint, p. 2,
 12 ¶¶ 4-5)

13 Plaintiff initially sued NICO in San Diego Superior Court. NICO
 14 caused the superior court action to be removed to this court on grounds of diversity
 15 - - Plaintiff being a citizen of California and NICO having its principal place of
 16 business and state of incorporation in Nebraska. (Complaint, pp. 2-3, ¶ 6)

17 The indebtedness of Frontier which NICO allegedly seeks to offset
 18 arose under a reinsurance agreement effective January 1, 1995, which is attached to
 19 the Complaint as Exhibit "A". (Complaint, p. 3, ¶ 9) The Complaint refers to this
 20 agreement as the Center Re Agreement, because Center Reinsurance Company of
 21 New York ("Center Re") was initially obligated as reinsurer thereunder. NICO
 22 became the ultimate Reinsurer under the Center Re Agreement by virtue of a
 23 Novation Agreement (Complaint, Ex. C) effective July 1, 2000. Both Frontier and
 24 FPIC were parties to the Novation Agreement. (Complaint, p. 4, ¶ 14) Under the
 25 Center Re Agreement, the Reinsured party was entitled to retain 92% of collected
 26 premium in order to defray losses (the "Center Re Funds Held"). Unexpended
 27 premium (the "Funds Withheld") was ultimately required to be remitted to the
 28 Reinsurer.

589576.1

2

1
2 Plaintiff alleges that as of October 15, 2001, when the Supreme Court
3 of the State of New York issued an Order of Rehabilitation respecting Frontier,
4 "Frontier owed approximately \$40 million in premiums to NICO under the
5 Novation Agreement to fund the Center Re Funds Held deficiency due at December
6 31, 2003." Review of the Center Re Agreement, Exhibit A, discloses that FPIC was
7 jointly and severally liable for the same indebtedness: page one of Exhibit A
8 defines Frontier and FPIC collectively as "the Company" and, pursuant to Article
9 XIG, "[t]he Company promises to pay the Funds Withheld Balance" on the earlier
10 of various stated contingencies. (Complaint, Ex. A, p. 7)

11 Notably, the Center Re Agreement contains the following provision for
12 comprehensive, binding arbitration: "Any dispute arising out of the interpretation,
13 performance or breach of this Agreement ... shall be submitted for decision to a
14 panel of three arbitrators. *** The panel shall render its decision within sixty (60)
15 days following the termination of hearings, which decision shall be in writing,
16 stating the reasons thereof. Judgment upon the award may be entered in any court
17 having jurisdiction thereof." (Complaint, Ex. A, pp. 17-18, Art. XXVII) The
18 Center Re Agreement likewise provides for the arbitration to proceed in New York
19 City, pursuant to the laws of the State of New York. (op. cit.)

20 NICO served as reinsurer for Frontier and FPIC under other agreements
21 as well. (Complaint, ¶¶ 17) Among these was an agreement with Frontier effective
22 July 1, 2000, (the "NICO Agreement") to which FPIC was added as a reinsured
23 effective October 1, 2000. (Complaint, Exs. D and E)

24 Subsequent to initiation of Frontier's insolvency proceedings, NICO
25 and Frontier entered into Endorsement No. 3 to the NICO Agreement. (FPIC was
26 not a party to Endorsement No. 3.) Under Endorsement No. 3, NICO forgave and
27 released Frontier of indebtedness in the amount of \$140,000,000. NICO agreed "not
28 to collect [the Center Re Funds Held balance at December 31, 2003] from Frontier

1 (emph. supp.) as part of the \$140,000,000 NICO balance forgiveness ...”
 2 (Complaint, Ex. H, p. 3, ¶¶ 8-9) While, pursuant to Endorsement No. 3, NICO
 3 clearly thus foregoes recourse against Frontier for recovery of the Center Re Funds
 4 Held balance, Endorsement No. 3 makes equally clear that NICO is not releasing
 5 other obligors - - such as FPIC: “The Reinsurer agrees that it may only collect the
 6 remaining funds held balance from the other participants to the Center Re
 7 Reinsurance Agreements and Novation,” subject to a veto right by Frontier.¹
 8 (Complaint, Ex. H, p. 3, ¶ 9)

9 The Complaint alleges that “Endorsement No. 3 has been fully
 10 performed by NICO and Frontier and Frontier and FPIC’s obligations under the
 11 Reinsurance Agreements for payment of premium has been fully discharged and
 12 satisfied.” (Complaint, p. 8, ¶ 37) Based on this contention, FPIC alleges NICO
 13 currently holds no setoff rights (e.g. that NICO is owed no Withheld Funds) and that
 14 NICO owes FPIC \$4,883,090 under the NICO Agreement. (Complaint, p. 9, ¶ 42;
 15 Ex. M)

16 Notably the NICO Agreement, to which FPIC is a party, contains the
 17 following provision for binding arbitration: “All matters in difference between the
 18 Reinsured and the Reinsurer ... in relation to this reinsurance, including its
 19 formation and validity, and whether arising during or after the period of this
 20 reinsurance, shall be referred to an Arbitration Tribunal ... *** The award of the
 21 Arbitration Tribunal shall be in writing and binding on the parties who covenant to
 22 carry out the same.” (Complaint, Ex. D, p. 9, Art. 18) As with the Center Re
 23 Agreement, the NICO Agreement provides that the Arbitration will proceed in New
 24 York City, in accordance with the laws of the State of New York.

25
 26 ¹ Frontier had an interest in whether the Center Re Funds Held balance was
 27 collected from other participants. To the extent the Center Re Funds Held balance
 28 was applied against claims of FPIC, this would preserve limits available to Frontier
 under the NICO Agreement.

1
2 The Complaint alleges a right to declaratory relief as to three issues:
3 that FPIC is not bound by Endorsement No. 3, as purportedly contended by NICO
4 (Complaint, First Cause of Action, pp. 9-10); that Endorsement No. 3 constituted an
5 accord and satisfaction as to the obligation of FPIC to pay the Center Re Funds Held
6 balance (Complaint, Second Cause of Action, p. 10); and for a determination that
7 NICO is barred by California Insurance Code section 1031 from setting off monies
8 it owes FPIC against monies due NICO from Frontier and otherwise discharged by
9 Endorsement No. 3. (Complaint, Third Cause of Action, pp. 10-11) The Complaint
10 thus asks the Court to determine the legal effect of Endorsement No. 3 on the Center
11 Re Agreement, as well as the validity of an affirmative defense raised by FPIC to
12 claims of NICO under the Center Re Agreement: accord and satisfaction. *See Mass*
13 *v. Melymont*, 1 Misc. 3d 906A, 2003 WL 23138786 (N.Y. Dist. Ct. 2003) (“In the
14 case at bar, accord and satisfaction as an affirmative defense can be raised by
15 defendant and employed successfully to preclude recovery providing that it is
16 properly raised.”). The Complaint in turn asks the Court to rule on an affirmative
17 defense asserted by NICO to claims of FPIC under the NICO Agreement - - the
18 affirmative defense of set off. *See Kivort Steel Inc. v. Liberty Leather Corp.*, 110
19 A.D.2d 950, 952, 487 N.Y.S.2d 877 (1985).

20 The Complaint further implicitly asks the Court to indulge the
21 assumption that FPIC is not now and never has been liable as a joint obligor with
22 Frontier for payment of the Center Re Funds Held balance – a proposition belied by
23 the very face of the Center Re Agreement.

24 NICO ’s Answer to Complaint discloses differences both over the
25 nature of matters in controversy and the substantive rights of the parties. For
26 example, NICO denies that Frontier has fully satisfied the Center Re Funds Held
27 obligation by virtue of Endorsement No. 3. (Answer to Complaint, ¶ 37) NICO
28 denies that its claim of set off arises under Endorsement No. 3 (Answer, p. 10, ¶ 46),

1 or by virtue of the indebtedness of Frontier, maintaining that it is entitled to assert
 2 setoff by virtue of the joint and several liability of FPIC as part of the collective
 3 “Company” under the Center Re Agreement. Similarly, NICO denies that
 4 Endorsement No. 3 has the legal effect of an accord and satisfaction as to FPIC.
 5 (Answer to Complaint p. 11, ¶ 50) To the extent that Endorsement No. 3 is
 6 susceptible to such a construction, NICO maintains that it is subject to reformation.
 7 (Answer to Complaint p. 12, ¶ 56) NICO further maintains that Frontier is an
 8 indispensable party to any dispute resolution process addressing rights under the
 9 Center Re Agreement and NICO Agreement. (Answer to Complaint p. 12, ¶ 55)

10 Remarkably, although both of the agreements which give rise to the
 11 current controversy provide for binding arbitration, the Plaintiff has refused NICO’s
 12 demand to submit the instant controversy to binding arbitration. (Declaration of
 13 Richard S. Conn) It is this refusal which necessitates the instant motion to stay this
 14 litigation pending arbitration proceedings mandated by the Federal Arbitration Act.

15 **II. GROUND FOR RELIEF SOUGHT**

16 By means of this motion NICO seeks an order staying prosecution of
 17 this action pending a resolution of all claims by binding arbitration. Issuance of a
 18 stay order is authorized by Section 3 of the Federal Arbitration Act, 9 U.S.C. § 3,
 19 which provides:

20 “If any suit or proceeding be brought in any of the courts
 21 of the United States upon any issue referable to arbitration
 22 under an agreement in writing for such arbitration, the
 23 court in which such suit is pending, upon being satisfied
 24 that the issue involved in such suit or proceeding is subject
 25 to arbitration under such agreement, shall on application of
 26 one of the parties stay the trial of the action until
 27 arbitration has been had in accordance with the terms of
 28 the agreement, providing the applicant for the stay is not in

1 default in proceeding with such arbitration.”

2 If the conditions of Section 3 are satisfied (*e.g.* the dispute is referable
3 to arbitration) issuance of a stay is mandatory. *See Complaint of Hornbeck*
4 *Offshore*, 981 F.2d 752, 754 (5th Cir. 1993); *Gutierrez v. Academy Corp.*, 967
5 F. Supp. 945, 947 (S.D. Tex. 1997); *Campeau Corp. v. May Dept. Stores Co.*, 723
6 F. Supp. 224, 226 (S.D.N.Y.1989).

7 Notably, a stay order may be issued independently of an order
8 compelling arbitration. Indeed, this may be necessitated where, as here, the action
9 to be stayed has been filed in a jurisdiction other than that where the arbitration is to
10 occur. (The instant arbitration provisions specify New York, New York as the locus
11 of the arbitration.) This follows from the proviso of 9 U.S.C. § 4 that the compelled
12 arbitration hearing “shall be within the district in which the petition directing such
13 arbitration is filed.” Since this court arguably cannot issue an order compelling
14 arbitration in New York, it is entirely proper that the relief sought by the aggrieved
15 party be limited to a stay order. *See Merrill Lynch, Pierce, Fenner & South Inc. v.*
16 *Lauer*, 49 F.3d 323, 327-328 (7th Cir. 1995); *Petition of Home Ins. Co.*, 908
17 F. Supp. 180, 182 (S.D.N.Y. 1995).

18 **III. ARGUMENT: THE COURT SHOULD STAY THIS ACTION**
19 **PENDING ARBITRATION OF CLAIMS**

20 **A. The Parties’ Arbitration Agreements Unambiguously Require**
21 **Arbitration Of This Dispute.**

22 In entering into the Center Re Agreement and Novation Agreement
23 described above, NICO and FPIC agreed to arbitrate “any dispute arising out of the
24 interpretation, performance or breach of this Agreement.” (Complaint, Ex. B, p. 17)
25 The arbitration provision under the NICO Agreement is no less broad: “All matters
26 in difference between the Reinsured and Reinsurer ... in relation to this reinsurance
27 ... shall be referred to an Arbitration Tribunal ...” (Complaint, Ex. D, p. 9) These
28 provisions unambiguously require arbitration of all disputes, including NICO’s

589576.1

7

obligations to the FPIC and NICO's right to set off sums due NICO from FPIC.

**1. Both Federal And California Law Strongly Favor
Arbitration And Require That Arbitration Agreements
Be Broadly Construed.**

In its decision in *Southland Corp. v. Keating*, 465 U.S. 1, 104 S.Ct. 852 (1984), the United States Supreme Court ruled that the Federal Arbitration Act ("FAA") governs the issue of arbitrability of disputes under any agreement to arbitrate that affects interstate commerce.² Thus, the Supreme Court in *Southland* held that "the underlying issue of arbitrability" in such a case is "a question of substantive federal law." *Southland Corp.*, 465 U.S. at 12, 104 S.Ct. at 859. See also *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626, 105 S.Ct. 3346, 3353 (1985) (in determining whether a dispute is subject to arbitration, the Court is to apply "federal substantive law of arbitrability, applicable to any arbitration agreement within coverage of the [Federal Arbitration] Act" (quoting *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24, 103 S.Ct. 927, 941 (1983)). Accordingly, federal law controls the issue of whether NICO's claims to a setoff are subject to arbitration. As demonstrated below, however, the issue of which law controls here is essentially moot as both federal and California law require arbitration.

The courts have consistently held that the strong policy favoring arbitration requires that agreements to arbitrate be broadly construed. The FAA,

² The reinsurance agreements at issue here are contracts "evidencing a transaction involving commerce" within the meaning of section 2 of the FAA, 9 U.S.C. § 2. See, e.g., *Ainsworth v. Allstate Insurance Co.*, 634 F. Supp. 52, 55-56 (W.D. Mo. 1985) (reinsurance agreements were contracts "evidencing a transaction involving commerce" within the FAA). Indeed, as the *Ainsworth* court noted, "that the agreements involve insurance may be enough to establish the interstate commerce connection." *Id.* at 55. Accord *Bernstein v. Centaur Insurance Co.*, 606 F. Supp. 98, 101 (S.D.N.Y. 1984) ("insurance is business in interstate commerce" under FAA); see also *United States v. South Eastern Ass'n*, 322 U.S. 533, 539-53, 64 S.Ct. 1162, 1166-73 (1944) (fire insurance business is interstate commerce under Commerce Clause and Sherman Act).

1 “both through its plain meaning and the strong federal policy it reflects, requires
2 courts to enforce the bargain of the parties to arbitrate, and ‘not substitute [its] own
3 views of economy and efficiency’ for those of Congress.” *Dean Witter Reynolds,*
4 *Inc. v. Byrd*, 470 U.S. 213, 105 S.Ct. 1238, 1241 (1985). In light of this policy:

5 An order to arbitrate the particular grievance should not be
6 denied unless it may be said with positive assurance that
7 the arbitration clause is not susceptible of an interpretation
8 that covers the asserted dispute. Doubts should be
9 resolved in favor of coverage.

10 *United Steelworkers of America v. Warrior Gulf Navigation Co.*, 363 U.S. 574,
11 582-83, 80 S.Ct. 1347, 1353 (1960). As the Supreme Court observed in a
12 subsequent decision:

13 ‘questions of arbitrability must be addressed with a
14 healthy regard for the federal policy favoring arbitration
15 ... The Arbitration Act establishes that, as a matter of
16 federal law, any doubts concerning the scope of arbitrable
17 issues should be resolved in favor of arbitration, whether
18 the problem at hand is the construction of the contract
19 language itself or an allegation of waiver, delay, or a like
20 defense to arbitrability.’

21 *Mitsubishi Motors*, 473 U.S. at 626, 105 S.Ct. at 3353-54 (quoting *Moses H. Cone*
22 *Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. at 24-25, 103 S.Ct. at
23 941-42).

24 California decisions are fully in accord with the foregoing rules. *E.g.*,
25 *Bos Material Handling, Inc. v. Crown Controls Corp.*, 137 Cal. App. 3d 99, 105,
26 186 Cal.Reptr. 740 (1982) (“In California, the general rule is that arbitration should
27 be upheld unless it can be said with assurance that an arbitration clause is not
28 susceptible to an interpretation covering the asserted dispute”).

589576.1

9

1
2 Under the above standard, not only claims, but also affirmative
3 defenses to claims, must be arbitrated. Thus, the Court in *Republic of Nicaragua v.*
4 *Standard Fruit Co.*, 937 F.2d 469, 478 (9th Cir. 1991) *cert. den.* 503 U.S. 919 states
5 that, when “enforcing agreements to arbitrate,” a court must “leav[e] the merits of
6 the claims and any defense to the arbitrator.” (emph. supp.) When a dispute is
7 subject to arbitration, the entire dispute - - including both claims and defenses
8 - - must be arbitrated. *See e.g. Prima Paint Corp. v. Flood & Conklin Mfg.*, 388
9 U.S. 395, 404 (1967) (defense of fraudulent inducement to be decided by arbitrators
10 hearing breach of contract claim); *National Union Fire Ins. Co. v. Belco Petroleum*
11 *Corp.*, 88 F.3d 129 (2d Cir. 1996) (preclusion defense to be decided by arbitrators);
12 *O’Neel v. NASD*, 667 F.2d 804, 807 (9th Cir. 1982) (statute of limitations defense
13 to be decided by arbitrators).

14 The mandate for arbitration applies equally where, as here, a later
15 executed settlement with a third party is the basis of the claimed defense. *Local*
16 *Union No. 370, Int’l Union of Operating Eng’rs v. Morrison-Knudson Co.*, 786 F.2d
17 1356, 1357-1358 (9th Cir. 1986). Nor have courts treated the defense of setoff as
18 exempt from arbitration. *Quackenbush v. Allstate Insurance Co.*, 121 F.3d 1372,
19 1380 (9th Cir. 1997).

20 Likewise, statutory claims, such as claims under the Racketeer
21 Influenced and Corrupt Organizations Act (RICO) and the federal securities laws,
22 must be submitted to arbitration when they fall within the scope of a contractual
23 agreement to arbitrate, unless Congress has expressly created an exception to the
24 Federal Arbitration Act. *Rodriguez de Quijas v. Shearson/ American Express, Inc.*,
25 109, S.Ct. 1917, 104 L.Ed.2d 526 (1989) (ordering arbitration of claims under
26 Securities Act of 1933); *Shearson/American Express, Inc. v. McMahon*, 482 U.S.
27 220, 107 S.Ct. 2332 (1987) (compelling arbitration of RICO claims and claims
28 under Securities Exchange Act of 1934).

2. **Under The Foregoing Standard, The Dispute Presented Here Is Within The Scope Of The Parties' Agreements To Arbitrate And Must Be Arbitrated By The Commissioner.**

There can be no dispute whether the claims asserted in this case fall within the scope of the parties' arbitration agreements. The Commissioner effectively seeks to recover reinsurance balances that have accrued under a reinsurance agreement pursuant to which NICO reinsured FPIC. This agreement has an arbitration provision. NICO seeks to set off balances that are due it under another reinsurance agreement pursuant to which NICO acted as FPIC's reinsurer. This reinsurance agreement also has an arbitration provision. These claims lie at the very heart of the contracts of reinsurance at issue in this case. It is difficult to imagine a clearer instance of a dispute concerning rights under the reinsurance agreements. Although citation of authority is hardly necessary, the cases have found that such disputes fall within the scope of arbitration agreements akin to those here, and are fully enforceable against liquidators of insurance companies. *E.g. Quackenbush v. Allstate Insurance Co.*, 121 F.3d 1372, 1380 (9th Cir. 1997) (compelling arbitration of dispute between Insurance Commissioner as Liquidator and reinsurer over rights of setoff); *Bennett v. Liberty National Fire Ins. Co.*, 968 F.2d 969, 971, 972 (9th Cir. 1992) (insurer's liquidator bound by insurer's pre-insolvency agreement to arbitrate all disputes arising out of its contractual relationship); *Ainsworth v. Allstate Insurance Co.*, 634 F. Supp. 52, 53-56 (W.D. Mo. 1985) (receiver of insolvent insurers must arbitrate claim against reinsurer in view of arbitration agreements contained in reinsurance treaties).

For the foregoing reasons, the Court should stay prosecution of this action pending a resolution of all claims through arbitration.

The foregoing decisions are consistent with the status of the Insurance Commissioner under the California Insurance Code. As several California decisions have recognized, the Insurance Commissioner, when acting as a conservator or

liquidator of an insolvent insurance company, has duties in the nature of a receiver. *E.g., Anderson v. Great Republic Life Insurance Co.*, 41 Cal. App. 2d 181, 106 P.2d 75 (1940). It has long been the law that “[a] receiver sues only on a cause of action of the parties or estate represented, and is subject to the same defenses which would have been available against them.” 4 B. Witkin, *California Procedure, Pleading* § 127 at 160 (1985); *see also, Allen v. Ramsay*, 179 Cal. App. 2d 843, 854, 4 Cal. Rptr. 575 (1960) (“A receiver occupies no better position than that which was occupied by the person or party for whom he acts and the receiver takes the property and the rights of one for whom he was appointed in the same condition and subject to the same equities as existed before his appointment and any defense good against the original party is good against the receiver”). Thus, the Commissioner’s power to avoid enforcement of an arbitration agreement can be no greater than that of FPIC, in whose shoes he must stand.

The McCarran-Ferguson Act, 15 U.S.C. §§ 1011-15, does not lead to a contrary result. The McCarran-Ferguson Act provides in relevant part that “[n]o Act of Congress shall be construed to invalidate, impair or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance.” 15 U.S.C. § 1012(b). The Ninth Circuit, however, has expressly held that state insurance law does not preempt the Federal Arbitration Act except in the event of an express conflict (*e.g.* a statute prohibiting arbitration of disputes with a liquidator). *Quackenbush v. Allstate Ins. Co.*, 121 F.3d at 1380-1381, citing *U.S. Dept. of Treasure v. Fabe*, 508 U.S. 491, 113 S.Ct. 2202 (1993); and *Bennett v. Liberty National Fire Ins. Co.*, 968 F.2d 969, 971-972. As acknowledged in *Quackenbush*, *supra*, no such conflict exists under California law.

B. Arbitration Of Reinsurance Disputes Is Particularly Appropriate.

That the present dispute concerns rights and obligations under reinsurance agreements makes arbitration particularly suitable. More than forty

1 years ago it was observed that “[i]t is the general practice and practically the
 2 uniform custom to provide in a [reinsurance] treaty for the arbitration of disputes
 3 arising out of the terms of the treaty.” K. Thompson, Reinsurance (4th Ed. 1966) at
 4 140. The federal courts, moreover, have routinely and repeatedly compelled
 5 arbitration of reinsurance disputes arising under such arbitration agreements. For
 6 instance, in *Houston General Insurance Co. v. Realex Group, N.V.*, 776 F.2d 514
 7 (5th Cir. 1985), the Court of Appeal reversed a District Court order which had
 8 refused to compel arbitration under the FAA of a suit substantially like that here:
 9 one brought by an insurer against its reinsurer seeking to recover balances due on a
 10 policy of reinsurance. *Houston General*, 776 F.2d at 516-17. Indeed, the Ninth
 11 Circuit ordered arbitration of a reinsurance dispute as early as 1928. *Pacific*
 12 *Indemnity Co. v. Insurance Co. of North America*, 25 F.2d 930 (9th Cir. 1928).

13 The near universality of arbitration agreements in the reinsurance
 14 industry has resulted from a number of factors. Among other things, arbitration
 15 offers a relatively prompt, expeditious method for determining the reinsurer’s
 16 obligation, if any, to pay reinsurance balances in dispute. Also, a resolution of
 17 reinsurance disputes involves both specialized terminology and a system of
 18 accounting that is unique to the insurance industry. Indeed, reinsurance disputes are
 19 so idiosyncratic that reinsurance arbitration agreements typically “require the
 20 arbitrators to be recognized authority in the field of which the case arises.”

21 K. Thompson, Reinsurance, at 140. The arbitration agreements at issue here contain
 22 just such provisions, requiring that the “arbitrators shall be disinterested active or
 23 former executive officers of insurance or reinsurance companies” (Complaint,
 24 Ex. A, p. 17, Art. XXVII D) or “persons employed or engaged in a senior position in
 25 Insurance or Reinsurance underwriting or claims.” (Complaint, Ex. D, p. 9, Art. 18)

26 The determination of the conflicting claims of NICO and FPIC would
 27 involve terminology and an accounting system that are unique to the reinsurance
 28 context. Judicial resolution of this dispute would put the parties to extraordinary

1 burden and expense, not to mention the expenditure of this Court's resources.

2
3 For the foregoing reasons, the Court should issue an order staying
4 prosecution of this action as against NICO. Such an order is mandated by section 3
5 of the Federal Arbitration Act, 9 U.S.C. § 3, which provides that a court "shall" stay
6 a civil action when it is subject to arbitration.

7 **C. The Order Of The Liquidation Of FPIC Is No Bar To The Relief**
8 **Sought.**

9 The Commissioner may argue that the Order Appointing Commissioner
10 As Liquidator And Restraining Order (the "Order") issued by the Superior Court
11 supervising FPIC's liquidation impedes the right of NICO to compel arbitration. A
12 careful reading of the Order discloses that the Order merely has the effect of
13 preserving assets over which the court exercises in rem jurisdiction from impairment
14 by imposition of liens, execution, levy, and the like.³ Nothing in the Order prohibits

15 ³ The specific provisions on which the Commissioner has placed reliance are
16 Paragraphs 24 through 29, which provide:

17 24. All persons are enjoined, except with leave of this Court issued
18 after a hearing in which the Commissioner as Liquidator has received
19 reasonable notice, from obtaining preferences, judgments, attachments
20 or other liens, or making any levy against Respondent or its assets or
21 property, and from executing or issuing or causing the execution or
22 issuance of any court attachment, subpoena, replevin, levy, execution
23 or other process for the purpose of impounding or taking possession of
24 Respondent or its affiliates, or the Liquidator appointed herein,
25 wheresoever situated and from doing any interfering with the conduct
26 of said business by the Commissioner as Liquidator.

27 25. All persons are enjoined, except by leave of this Court obtained
28 after reasonable notice to the Commissioner as Liquidator, from
accelerating the due date of any obligation or claimed obligation;
exercising any right of set-off; taking, retaining, retaking or attempting
to retake possession of any real or personal property; withholding or
diverting any rent or other obligation; doing any act or other thing
whatsoever to interfere with the possession of or management by the
Commissioner as Liquidator and of the property and assets, owned or
controlled by Respondent or in the possession of Respondent or to in
any way interfere with said Commissioner as Liquidator or to interfere
in any manner during the pendency of this proceeding with the
exclusive jurisdiction of this Court over Respondent.

award of declaratory relief by arbitration. Indeed, in the absence of a California statute prohibiting arbitration of disputes by a liquidator, such an order would

26. Respondent, its officers, directors, governors, agents, and employees are enjoined from transacting any of the business of Respondent, whether in the State of California or elsewhere, or from disposing of, or assisting any person in the transfer or alienation of, the property or assets of Respondent, until further order of this Court.

27. All persons are enjoined from instituting, prosecuting or maintaining any action at law or suit in equity, including but not limited to actions or proceedings to compel discovery or production of documents or testimony and matters in arbitration, against Respondent or against the Commissioner as Liquidator of Respondent, and from attaching, executing foreclosure upon, redeeming of or taking any other legal proceedings against, any of the property or assets of Respondent, and from doing any act interfering with the conduct of said business by the Commissioner as Liquidator, except upon order from this Court obtained after reasonable notice to the Commissioner as Liquidator.

28. Any and all provisions of any agreement entered into by and between any third party and Respondent including, by way of illustration, but not limited to, the following types of agreements (as well as any amendments, assignments, or modifications thereto); financial guarantee bonds, promissory notes, loan agreements, security agreements, deeds of trust, mortgages, indemnification agreements, subrogation agreements, subordination agreements, pledge agreements, assignments of rents or other collateral, financial statements, letters of credit, leases, insurance policies, guaranties, escrow agreements, management agreements, real estate brokerage and rental agreements, servicing agreements, attorney agreements, consulting agreements, easement agreements, license agreements, franchise agreements, or employment contracts that provide in any manner that selection, appointment or retention of a conservator, or liquidator or trustee by any court, or entry of an order such as hereby made, shall be deemed to be or otherwise operate as a breach, violation, event of default, termination, event of dissolution, event of acceleration, insolvency, bankruptcy, or liquidation, shall be stayed, and the assertion of any and all rights, remedies relating thereto shall also be stayed and barred, except as otherwise ordered by this Court, and this Court shall retain jurisdiction over any cause of action that has arisen or may otherwise arise under any such provision.

29. All persons are enjoined from interfering with the possession, title and rights of the Commissioner as Liquidator, in and to the assets of Respondent, and from interfering with the conduct of the Commissioner as Liquidator in the handling and disposition of assets of Respondent, and from interfering with the conduct of the liquidation and the winding up of the business of Respondent, except upon order of this Court obtained after reasonable notice to the Commissioner as Liquidator.

1 contravene the Federal Arbitration Act and would, as such, be void. As the Court
 2 held in *Quackenbush*, 121 F.3d at 1381, arbitration of claims pursued by a California
 3 liquidator outside of the statutory insolvency proceedings “will not interfere with
 4 California’s insolvency scheme” and is therefore controlled by the Federal
 5 Arbitration Act.

6 Furthermore, to the extent the Order might be deemed to contravene the
 7 Federal Arbitration Act, it is properly challenged by disregard. *People v. Gonzalez*,
 8 12 Cal.4th 804, 818-819, 50 Cal. Rptr. 2d 74 (1996).

9 **IV. CONCLUSION**

10 As demonstrated above, both federal and California law guarantee
 11 NICO’s right to arbitrate its dispute with the FPIC and the Commissioner. This
 12 Court should therefore stay prosecution of this action by the Commissioner pending
 13 resolution of all claims by arbitration, as the parties expressly agreed in the
 14 reinsurance agreements that are the subject of this action.

15
 16 DATED: June 27, 2008

MUSICK, PEELER & GARRETT LLP

17
 18 By: s/Richard S. Conn
 19 Richard S. Conn
 20 Attorneys for NATIONAL INDEMNITY
 21 COMPANY
 22
 23
 24
 25
 26
 27
 28

PROOF OF SERVICE

STATE OF CALIFORNIA
COUNTY OF LOS ANGELES

I am employed in the County of Los Angeles, State of California. I am over the age of 18 and not a party to the within entitled action; my business address is One Wilshire Boulevard, Suite 2000, Los Angeles, California 90017-3383.

On June 27, 2008, I served the foregoing document(s) described as **MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF DEFENDANT NATIONAL INDEMNITY COMPANY'S MOTION TO STAY PROSECUTION OF ACTION PENDING ARBITRATION OF CLAIMS** on the interested parties in this action by placing a copy thereof enclosed in a sealed envelope addressed as follows:

See Attached List

☒ **BY MAIL.** I caused such envelope with postage thereon fully prepaid to be placed in the U.S. Mail at Los Angeles, California. I am "readily familiar" with the firm's practice of collection and processing correspondence for mailing. Under that practice, it would be deposited with the U.S. postal service on that same day with postage thereon fully prepaid at Los Angeles, California in the ordinary course of business. I am aware that on motion of the party served, service is presumed invalid if postal cancellation date or postage meter date is more than one day after date of deposit for mailing in affidavit.

☒ **BY ELECTRONIC MAIL OR ELECTRONIC TRANSMISSION.** Based upon the Court's order for mandatory e-filing, I provided the documents listed above electronically to the Court's website and thereon to those parties on the Service List maintained by that website by submitting an electronic version of the documents to the Court's website. The documents are deemed filed and served on the date that they were uploaded to the Court's website.

☐ **BY FACSIMILE TRANSMISSION.** I caused such document to be transmitted to the addressee(s) facsimile number(s) noted herein. The facsimile machine used complies with Rule 2003 and no error was reported by the machine. Pursuant to Rule 2008(e), I caused the machine to print a transmission record of the transmission, a copy of which is attached to this declaration.

Executed on June 27, 2008, at Los Angeles, California.

☐ **(State)** I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

☒ **(Federal)** I declare that I am employed in the office of a member of the bar of this Court at whose direction the service was made. I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

s/Kathleen Slevcove
Kathleen Slevcove

SERVICE LIST

EDMUND G. BROWN, JR. Attorneys for Plaintiff Steve Poizner,
Attorney General of the State of Insurance Commissioner of the State of
California California in his capacity as Liquidator
of Frontier Pacific Insurance Company
W. DEAN FREEMAN
Supervising Deputy Attorney General
DIANE SPENCER SHAW
LISA W. CHAO
Deputy Attorneys General
300 South Spring Street, Suite 1702
Los Angeles, California 90013
Telephone: (213) 897-2486
Fax: (213) 897-5775
LAZLO KOMJATHY, JR. Attorneys for Plaintiff Steve Poizner,
Department of Insurance Insurance Commissioner of the State of
45 Fremont Street, 24th Floor California in his capacity as Liquidator
San Francisco, California 94105 of Frontier Pacific Insurance Company
Telephone: (415) 538-4413